2005

SOLANA
RESOURCES LIMITED

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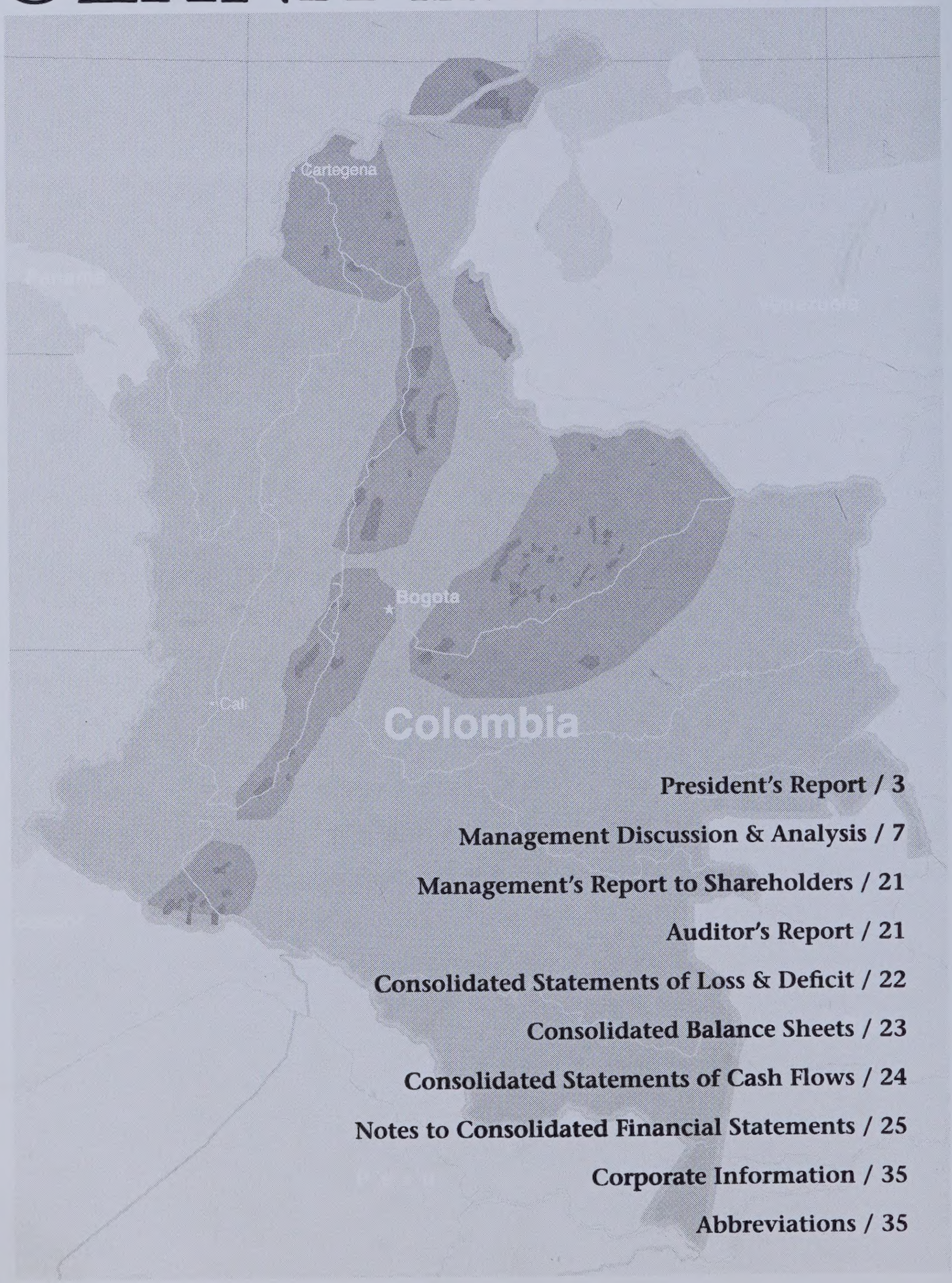


President's Message

The year 2005 was a very active year for Solana Resources Limited ("Solana" or the "Company"). The Colombia focused strategy employed by Solana, through its wholly owned subsidiary, Solana Petroleum Exploration Colombia Limited ("Solana Colombia"), resulted in first oil production in May 2005 and the initiation of cash flow two months later.

Summary of Highlights

Average oil production 500 bopd for 2005, NIL for 2004

Five additional blocks with 740,000 gross acres available for exploration

Gross revenues in excess of $ 9 million for 2005 versus $ 0.6 million for 2004

Exploration activities amounted to approximately $ 33 million for 2005, made up of $7.8 million directly attributable to dry holes, $12.7 million associated with discoveries, $4.8 million with wells awaiting testing and $7.7 million primarily associated with seismic and location construction associated with wells that will be drilled in 2006

In the spring of 2006 raised additional funds of $ 39 million for continued exploration

Contracted a drilling rig for 1 year with an option for another year

Solana continues to expand its presence in Colombia in the face of increasing competition for both exploration blocks and services. This is achieved by maintaining strong links with the involved government agencies and the exploration community in general. While the situation with respect to the procurement of drilling and other technical services has become more complicated and competitive worldwide, the two year agreement that Solana signed with a Colombian drilling company whereby a rig is available to our Company on a first right of use basis, should ensure we comply with all obligations. This rig is currently drilling its first well for Solana (Gaviotas 1, which spudded April 20, 2006) and given that many companies in Colombia are now facing drilling deadlines at a time of very limited rig availability, the Solana option to use this rig could allow our Company to enter into other attractive exploration areas.

During the course of the year Solana has added to its prospect inventory through the acquisition of an additional 5 exploration blocks (Guachiria Sur, Garibay, Catguas, Carbonera, Chaza) totaling 740,000 gross acres (530,000 net to Solana), all of which are interpreted to contain drillable prospects. Most of these prospects exist as a result of 9 seismic programs (Guachiria – 2 programs, Gaviotas – 2 programs, Guachiria Sur, Guachiria Norte, Garibay, Catguas, Carbonera) which Solana has acquired over the course of the past 16 months.

The Company has a number of relatively lower risk prospects that are either in the process of being drilled or are awaiting the availability of rigs to either test or drill. Solana's inventory of large prospects balances this portfolio and promises a weighted balance to its drilling and the risk reward of the Company's portfolio of prospects.

Through fiscal 2005 Solana participated in the drilling of 7 wells (Guayuyaco 1, Sirruma, Molino de Viento, Guayabillas, Guayuyaco 2, Balu, and Puma). Two of these wells are now on production and a third is awaiting testing. In addition, the Company participated in a commercial discovery, Guariquies, in early 2006.

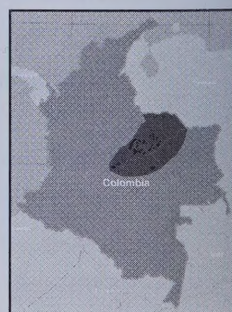
The Solana drilling program has to date, tested 5 (Sirruma, Molino de Viento, Guayabillas, Guariquies, Guayuyaco) of the original 10 (Sirruma, Molino de Viento, Malabares, Gaviotas, Guayabillas, Puma, Guariquies, Zeus, Alamo, Guayuyaco) targets in its exploration prospect inventory. One well from this inventory (Puma) is completed waiting to be tested and three more are currently drilling (Guariquies 2,

Gaviotas, Yalea). As well, Solana drilled two wells (Balu September 2005, Bonaire April 2006) which have been added to the original prospect inventory one of which (Bonaire) is completed and waiting to be tested.

Solana's exploration program in Colombia has always been premised on maintaining a portfolio of prospects. Risk mitigation is a consequence of our geographical and geological basin diversity. Our Company is represented in all significant oil producing basins in Colombia and our presence in these can be summarized as:

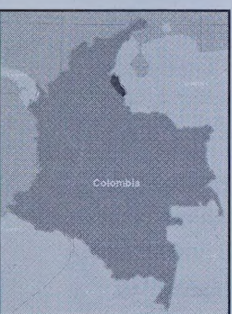
In the Putumayo Basin, which is in southern Colombia near Ecuador, Solana is involved in three separate exploration blocks; Guayuyaco, Chaza and Puma. On the Guayuyaco Block, the Company currently derives approximately 500 bopd of net production and is planning to participate (35% net revenue interest) in an additional exploration well in the second half of 2006. The Chaza Block, adjacent to Guayuyaco, was acquired in mid 2005 and a 2D seismic program was completed late the same year and has defined at least one drillable structure of significant size. The Puma well, an 18.75% revenue interest to the Company, was drilled and Solana believes that three zones merit testing. This well has been completed and suspended pending the sourcing of a workover rig to conduct testing operations.

In the Middle Magdalena Basin, in central Colombia, Solana participated (33.75% revenue interest) in the drilling of the Guariquies well. This well tested oil from two zones, one deeper at approximately 10,000 feet which produced around 400 barrels of 36 deg. API oil during the test and the other shallower (5,400 to 6,500 feet) which produced at 200 to 400 bopd of 29.5 deg. API oil with no water over an 80 feet perforated interval. The significance of the lower zone is currently under engineering study to determine whether the relatively low permeability which characterizes this reservoir can be stimulated to produce at commercial rates. The upper zone is expected to be placed on production initially by trucking to a receiving facility less than 10 km away. An appraisal well, Guariquies 2, spudded on April 14, 2006 from the same surface location as the Guariquies 1 discovery and deviated some 500 meters. A third well, Guariquies 3, has been agreed to by the partners and is expected to be drilled at a location more than 4 km from the original discovery in the second half of 2006. The full significance of the Guariquies discovery will only be known after the drilling of a number of additional appraisal wells, as the mapped area of the structure covers an area at least 10 km long in a north-south direction. The presence of other large fields in the region of the discovery aside from providing underutilized infrastructure is considered to be a positive factor for the possible existence of a significant oil accumulation at the Guariquies field.



In the Llanos Basin, located east and south east of Bogotá, Solana currently holds 5 exploration Blocks (Guachiria, Gaviotas, Guachiria Norte, Guachiria Sur, and Garibay). 2D seismic programs have completed on all of these Blocks in 2005 and early 2006 and the drilling of the initial prospects defined by these programs is now underway. The first well to be drilled, Bonaire 1 on the Guachiria Norte block has been drilled in April 2006, and has been logged and cased. The Company is awaiting the arrival of a test rig to conduct tests on two potentially oil bearing zones. A second well, Gaviotas 1, has spudded on the Gaviotas block on April 20, 2006 and is expected to be completed within two months. A third well, Yalea 1, on the Guachiria block at a location less than 2 km to the south of the existing and producing Bucaro well, is expected to spud in the next few days. The Bucaro well, the subject of a re-entry by a third party under a sole

risk agreement, in late 2005, is currently producing at a low rate and the facilities are underutilized. In the event of a discovery in the Yalea and/or Bonaire wells, the produced fluid would be treated in these facilities, thus expediting commercial production. The all weather road built for the Bucaro development will further the development of a discovery and the evacuation of the produced oil. The wells and the seismic programs discussed above complete all of the currently outstanding exploration commitments on the Llanos Basin Blocks.



Solana acquired a large acreage position comprising 450,000 gross acres (300,000 net) in the Catatumbo Basin in eastern Colombia (near Venezuela) in 2005 and early 2006. This basin, an extension of Venezuela's prolific Maracaibo Basin, is believed to be highly prospective. This prospectivity is supported by the existence in both Venezuela and Colombia of several fields which have already produced more than 100 million barrels of oil and the Solana acreage, comprising the Catguas and Carbonera Blocks, lies immediately adjacent to one of these large fields. Both of the Solana operated Blocks encompass gas discoveries, one of which includes two successful appraisal wells. The Catguas Block also contains at least two wells drilled in the 1950's which produced oil on very restricted open hole tests. Exploration in the Catatumbo Basin has in the past been impeded by security concerns, however the government is very aware of both the security issue and the oil potential in this basin and have moved to establish a strong government presence. Solana feels that these risks are manageable if the government's security initiatives are combined with an active community relations program. In witness of this, it is noted that Solana is about to complete 2D seismic programs on both of the Catatumbo Basin Blocks on schedule. These seismic programs have delineated a number of large prospects, one of which is expected to be drilled in late 2006.

The political, security and economic situation in Colombia continues to improve. The constitutional change to allow the reelection of the President was approved in 2005 and the recent Congressional and Senate elections resulted in parties aligned with the current President having control of both the Congress and the Senate. The current President is well ahead in the opinion polls and is expected to win in the elections scheduled for the end of May, 2006. Based on this scenario, the Government can be expected to continue to promote international investment in the oil industry. In addition to improving the security in the operating areas, the highly attractive fiscal terms introduced at the beginning of 2004 have generated a strong industry response with 31 contracts and 28 technical evaluation agreements signed in 2005, an increase of 110 % over 2004. Industry activity has also increased with 35 exploration wells drilled in 2005, 67 % more than the 21 wells drilled in 2004. Competition for new acreage is now strong and in the Llanos basin, where Solana Colombia has five blocks, the entire basin is now virtually fully leased.

Solana with its extensive exploration acreage and prospect portfolio is well positioned to operate in this more competitive environment and continues to receive proposals by companies wanting to join the Solana exploration programs on a promoted basis. Indeed, the Company has accepted one such proposal whereby a Colombia company will earn a 30% interest in 4 of the Solana held Llanos basin blocks in return for bearing 60% of the cost of drilling 5 wells. The philosophy which the Company employs in evaluating such farmin proposals is that in general the potential farminee must bring to the Solana assets some strategic added value such as access to drilling rigs, infrastructure, technology or project specific information rather than only exploration funding. Solana also continues to review its exploration portfolio and has specifically decided to seek partners for two of its large exploration projects that while being very attractive, would consume a disproportionate amount of the exploration budget.

The favorable Colombian contract terms noted previously include a government take based on a sliding scale royalty, beginning at 8%, corporate income tax, currently 38.5% and an increased state take when oil prices are above an inflation adjusted base of just under US$30 per barrel. Thus, while other countries have moved to renegotiate contract terms in the light of the high prices, the Colombian fiscal model already ensures additional state participation in higher crude prices resulting in a more stable fiscal environment. In addition, 60% of the royalties are distributed by law to the municipalities and departments (states) where the oil is produced thus ensuring local community participation in the benefits.

Along with its increased exploration activity, Solana has grown to include a total staff of approximately 25 including a core exploration staff of 9 professionals with specific responsibility for the four basins where Solana operates. It continues to be a strategic operating procedure of the Company to focus its value added proposition to the exploration arm of the company and to continue to target the best acreage and prospects available in Colombia while outsourcing many of the other activities, mainly operational, under the supervision of experienced professionals with many years of Colombian experience. We have also recently moved to strengthen our financial controls, planning and evaluation skills and our ability to access the best available technology through strategic agreements with the large service companies.

During 2005, Solana has continued to aggressively put into place a Health, Safety and Environmental ("HES") program. The activity levels sparked by the recent high oil prices have resulted in a shortage of equipment, services and above all, experienced personnel. Solana is and will continue to be very dependent on contractors. While oil companies will have difficulty maintaining HES standards in this time of enhanced activity, ensuring service companies comply with all appropriate standards becomes even more challenging. Solana has paid significant attention to ensuring all contractors comply with the policies and procedures outlines in the company contractors' manual. The Company has created field HES positions whose responsibility will be to monitor compliance with this manual however the absence of experienced personnel is complicating the filling of these positions.

In keeping with the Company's stated desire to be recognized as a leader in the area of health, safety, environment and quality assurance, we are also currently in the process of undergoing ISO 14000 certification, estimated for August, 2006 and ISO 18000 certification, estimated for June, 2006. This will be followed by ISO 9000 certification in 2007.

Solana has moved to broaden and strengthen its Board of Directors in 2005 with the addition of Joaquin Moreno, a highly experienced international oil executive, including 33 years with a major oil company, an intimate knowledge of the Colombian operating environment and with a broad Latin American knowledge base.

Solana's prime focus will remain on Colombia for the foreseeable future. However, as a result of industry relationships that we have formed, opportunities in other countries are being presented to the Company. To date, none have warranted diverting resources from our Colombian activities, however we remain open to attractive opportunities in relatively stable operating environments.

In summary, Solana continues to possess an attractive portfolio of projects. The Company has current production and anticipates building on that base through the appraisal and development of the Guariquies discovery. In addition, a number of relatively lower risk structures are either in the process of being drilled or are awaiting the availability of rigs to either test or drill. To this should be added a large, very attractive acreage position in very prospective basins that has the potential to yield large discoveries.

Management Discussion & Analysis
for the year ended December 31, 2005

The discussion and analysis that follows is intended to provide a summary of Solana Resources Limited's ("Solana" or "the Company") activities and results for the year ended December 31, 2005 as well as its financial position at December 31, 2005 and future prospects. It should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2005 and 2004. All numbers in this discussion and analysis are expressed in Canadian dollars unless otherwise indicated.

Solana is engaged in the exploration for and the acquisition, development and production of oil and natural gas. The company's exploration and development properties are located in Colombia, South America.

Additional information is available on the Company's website at www.solanaresources.com or on Sedar's website at www.sedar.com.

Highlights

14 exploration/production blocks currently held with firm drilling commitments on seven blocks. Six blocks were acquired in 2005 and early 2006.

A commercial oil discovery made at Guayuyaco in early 2005 which is producing at approximately 1400 bopd gross (500 bopd net to Solana) from two wells.

Drilling in early 2006 resulted in a commercial discovery at Guariquies 1. This discovery has led to two near-term appraisal/development locations. The first of these is currently drilling.

Four blocks held for production including; Guayuyaco, Magangué, Guariquies, and Guachiria.

Three blocks held under an option within an agreement between Ecopetrol, Ramshorn, and Solana may lead to future drilling on large prospects.

Drilling is currently underway at three locations on Solana acreage and the drilling program will continue for 12 to 18 months

Six 2D seismic programs completed in 2005 and early 2006 on Company held acreage

Company Objectives

To become the preeminent non-major explorer and producer in Colombia. Solana was one of the most active exploration companies in Colombia in 2005 in terms of the number of exploration wells in which it has participated, and expects to be so again in 2006.

To shoot seismic and to drill at least eight wells at a cost of $US 35 million within 12 months on mature prospects already identified and mapped and as many as 20 additional wells in future years on exploration acreage already held by the Company over the next 24 to 36 months

To participate at a significant working interest level in the drilling of both modest-sized, low-risk features expected to generate early cash flow and in large prospects with the potential to have a large impact on the value of the Company.

Solana's Assets

The exploration areas held by the Solana are located throughout Colombia and are focused in the Magdalena, Llanos, Catatumbo and Putumayo Basins and are all close to producing fields and infrastructure. Solana holds acreage by virtue of its 100% ownership of Solana Colombia. Solana Colombia is a private Cayman Islands company with a registered branch in Colombia.

Solana has varying interests in Colombia in fourteen exploration areas (seven Company operated) totaling approximately 1.0 million gross and 0.7 million net acres.

Solana operates the Guepaje Gas Field, presently producing 4.1 MMCF/day and participates in the producing Guayuyaco and Inchiyaco oil fields, which produces at a combined rate of approximately 525 boepd net to the Company. Solana's production at Guayuyaco is held via a 35% net participating interest in an exploration/development block named Guayuyaco in southern Colombia operated by a partner, Argosy Energy LLP. A discovery, Guayuyaco 1, made in March 2005, is producing at commercial rates and this was followed by Guayuyaco 2, also on commercial production. The two wells are producing approximately 500 bopd, net to Solana.

In early 2006 Solana participated in the Guariquies 1 discovery, a well which was drilled under the terms of a Shared Risk Contract ("SRC"). The participants in this Agreement are Ecopetrol (the Colombian State Oil Company), Ramshorn (a subsidiary of Nabors Drilling), and Solana. Solana participates in the SRC under the terms of a Commercial Agreement with Ramshorn to the point of a commercial discovery. Thereafter, as in the case of the Guariquies discovery, described below, Ecopetrol has agreed to assign the interest applicable directly to Solana. The Company paid 48% of the cost of the Guariquies well to the point at which the well was cased and will pay 37.5% of the cost of completing the well and the cost of future wells in this area and will earn a 33.75% interest in any production. The Guariquies well tested at commercial rates and an appraisal well is now drilling to follow up the discovery. Civil works have been completed at the Guariquies 1 well location to allow the Guariquies 1 well to be put on a long term production test with the oil being trucked to nearby production facilities.

Solana Colombia formerly held a 100% interest (subject to a 30% back-in right by Ecopetrol, the Colombian state-owned oil company) in the Salinas Block located in northeast Colombia. The Company drilled two unsuccessful wells on the property in early 2005 and surrendered its rights in this Block to Ecopetrol in December 2005.

Outlook

In January of 2004, the Colombian authorities implemented new regulatory and fiscal policies intended to encourage oil industry investment in the country. Solana responded quickly and decisively to these incentives and is currently focused on Colombia, is fully operational and well funded. The company is active in all major hydrocarbon basins in the country and proposes to apply modern exploration technology to its projects. A number of historical, economic and technical factors support the Solana decision to concentrate on Colombia including:

Historic discoveries have created a strong oil and gas industry; however, under-investment and under-exploration in the past two decades have resulted in falling production and the recognition by all levels of the Colombian Government that the country would soon lose its oil self-sufficiency unless action was taken. Consequently a number of measures were implemented in the past three years to attract foreign investment into the oil and gas industry. The success of this is demonstrated by the fact that more than 60 new Exploration Contracts and Technical Evaluation Agreements have been signed in the past 18 months. Solana was an early mover in this process and continues to compete aggressively in this acreage-acquisition effort.

The hydrocarbon potential of the country is significant in terms of the overall economy and much of it remains untapped due to a lack of investment in the last 20 years.

Widespread under-utilized infrastructure exists in most Colombian basins and specifically near all current Solana prospects.

The fiscal terms were revised as of January 2003, making Colombia an attractive country in which to invest in the oil and gas industry. These fiscal incentives increased the share of revenue which the investor could obtain from 27% to 50%.

The most modern exploration technology, especially in regards to seismic, drilling and reservoir management, has only been applied in a limited manner during the past 20 years. Solana is now applying such technology in its operated exploration blocks.

Colombia has a stable economy, with low inflation and consistent economic growth and, due to the fact that it has never defaulted on a debt payment or breached a contract with foreign investors, is a favored location for direct foreign investment.

The Colombian authorities provide essentially unlimited access to all technical information on oil and gas blocks.

The security situation in the country, which has long hampered exploration, has improved significantly and is expected to continue to improve.

Financing

On April 18, 2006, the Corporation completed a short form prospectus offering of 21,000,000 Common Shares at a price of $2.00 per Common Share for gross proceeds of $42,000,000 . Net proceeds of the Offering, amounting to $39,230,000, will be substantially used to fund the Corporation's continuing exploration activities in Colombia.

Solana's Projects

ECOPETROL / RAMSHORN / SOLANA PROJECT

Guayabillas 1, Guayabillas Area, Upper Magdelanena Basin

Between December 11, 2004 and February 5, 2005, Solana Colombia participated in the drilling of the Guayabillas 1 well under the terms of the SRC. This well was unsuccessful and subsequently abandoned.

Puma Prospect, El Pital Area, Putumayo Basin

The Puma well was drilled in the Putumayo Basin of southwestern Colombia to a final total depth of 12,225 feet in September 2005 and logged. The Puma well was the second well drilled under the terms of the SRC between Ecopetrol and Ramshorn. Under the terms of this contract Solana is entitled to a 75% interest in Ramshorn's share of any production derived from a discovery and since Ramshorn has a 30% working interest in the Puma prospect, Solana's net share of any production ultimately obtained from this prospect, if any, will be 18.75%. The participants have decided to suspend the well and replace the large and relatively costly drilling rig with a smaller service rig to conduct drill stem tests on a number of objectives in the well. Discussions continue with the operator regarding the testing program for the Puma well and the service rig is in the process of being secured for this operation.

Guariquies Prospect, De Mares Area, Upper Magdalena Basin

The Guariquies 1 well was drilled under the terms of the SRC. Solana Colombia paid 96% of Ramshorn's share of the initial cost to casing point to earn 75% of Ramshorn's 45% working interest. The Guariquies 1 well took 71 days to reach the final total depth of 10,243 feet at a cost of approximately US$7.5 million. Completion of the well, remedial cementing and subsequent testing operations took 74 days at an additional cost of approximately US$5.5 million. On February 28, 2006, in recognition of the commercial completion of the Guariquies 1 well, Solana Colombia received notice from Ecopetrol that a transfer of interest from Ramshorn to Solana Colombia in the Guariquies 1 well had been approved. In future wells, Solana Colombia will participate directly in the SRC as it pertains to the Guariquies prospect and will pay 37.5% of the costs and receive 33.75% of the production.

Civil works recently completed at the Guariquies 1 well location will allow Guariquies 1 well to be put on a long term test with the oil being trucked to nearby production facilities. An appraisal well, Guariquies 2, is currently drilling from the

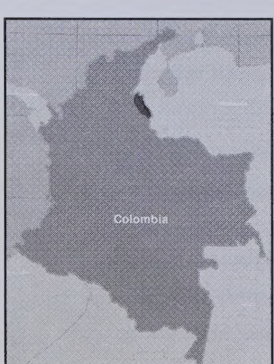
Guariquies 1 well location. This well is targeted at a Mugrosa Formation sands which were found to be oil productive at Guariquies 1. An additional appraisal well has been agreed by the partners and is expected to be drilled in late 2006 at a location approximately 4.5 km north of the discovery well. The total cost of the Guariquies 1 discovery, which included extensive testing and drilling to a deeper target at more than 10,000 feet was approximately $US15 million. Future development wells, which will produce only the Mugrosa formation, found between 5,000 and 7,000 feet, are expected to require smaller and less expensive drilling rigs than that used to drill the Guariquies 1 well. Such wells are expected by management of the Company to cost in the range of US$3 to US$6 million during the appraisal phase. When additional information is gathered on both the Mugrosa and the deeper La Paz formation, management expects well costs during the full development of the Mugrosa reservoir to decrease to between US$2.0 and US$2.5 million, which is the average cost for development wells in the surrounding fields.

The Guariquies 1 well was programmed to test several individual objectives on a deviated trajectory. For this reason, management of the Company believes that the Guariquies 1 well penetrated only part of the productive Mugrosa formation. The Guariquies 2 appraisal well, now drilling, has been targeted to penetrate the full Mugrosa formation which, based on surrounding wells, is expected to be thicker than that tested in the current well.

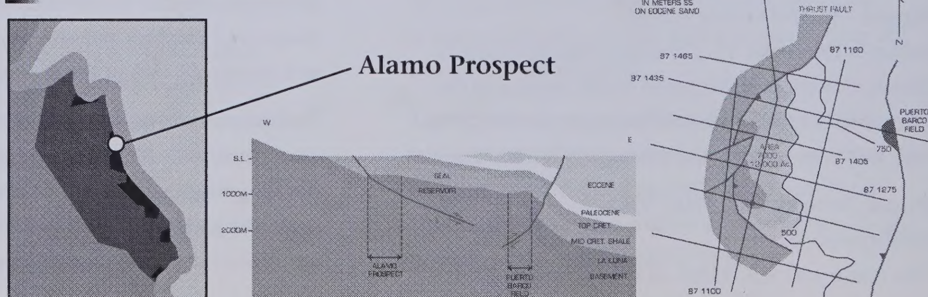
Alamo Prospect, Alamo Area, Catatumbo Basin

The Alamo prospect is located in the Catatumbo basin in the east central part Colombia. The Catatumbo basin, unlike the basin to the west, belongs, in a geological sense, to the Maracaibo basin system of Venezuela. The Maracaibo basin has produced an estimated 37 billion barrels of oil to date, with 20 billion barrels estimated to remain to be produced.

The well proposed to test this prospect is expected to penetrate to 4,800 feet. The well will be drilled under the terms of the SRC. Solana Colombia will pay 96% of Ramshorn's share of the initial cost to casing point to earn 75% of Ramshorn's working interest. Solana will bear 38.4% of the cost of the initial well and 30% of the cost of subsequent wells and will earn a 26.25% interest in production subject to a sliding scale royalty. The Company expects the well to be spudded in Q3 of 2006. The Alamo well, which will be a helirig operation to take into account sensitivities to the local environment, is expected to cost an estimated US$15 million. Solana's share of the drilling costs is estimated at US$5.8 million on a dry hole basis and Solana's share of any production ultimately obtained from this prospect will be 26.25%.



Catatumbo Basin



Zeus Prospect, Rio Horta Area, Middle Magdalena Basin

The Zeus prospect is one of the largest undrilled prospects in Colombia and represents an attractive exploration target with a considerable amount of well control. It is a deep prospect (18,000 feet) and is expected to take 135 days to drill, with a further 40 days for testing, with an anticipated dry hole cost of US$10 million net to Solana. The well proposed to test the Zeus prospect is the deepest, largest target and most expensive well planned to be drilled among the Ecopetrol/Ramshorn/Solana Prospects.

The Zeus well will be drilled under the terms of the SRC. Solana will pay 96% of Ramshorn's share of the initial costs to casing point to earn 75% of Ramshorn's working interest. Solana will bear 48% of the cost of the first well on this prospect and 37.5% of the costs of subsequent wells and will earn a 33.75% interest in the production subject to a sliding scale royalty.

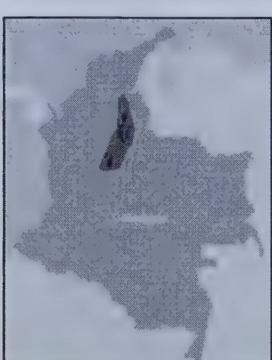
CATATUMBO BASIN PROJECTS

Cataguas Block

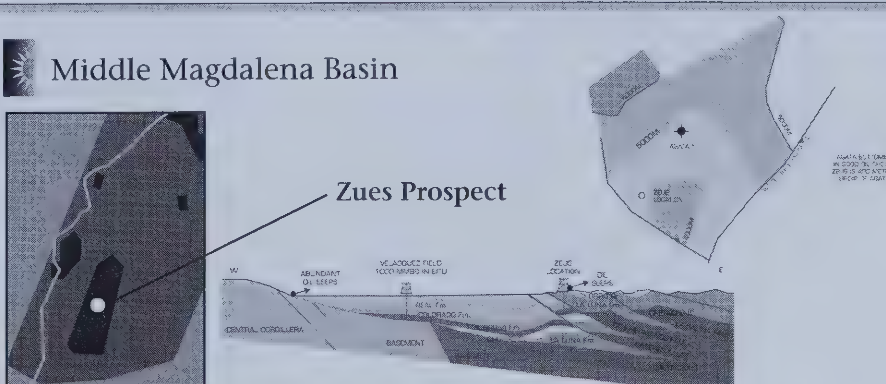
The Catguas Block located in the Catatumbo basin in northeastern Colombia encompasses approximately 393,000 acres and was granted to Solana by the ANH on October 14, 2005.

This basin is the western extension, into Colombia, of the Maracaibo basin of Venezuela. The Maracaibo basin has produced an estimated 37 billion barrels of oil to date with 20 billion barrels estimated remaining to be produced. In Colombia, immediately adjacent to the Catguas Block, are fields such as the Tibu field (found in 1940 and with 260 million bbls produced to date), the Petrolea field (discovered in 1934 with 38 million bbls produced to date) and the Rio Zulia field (dating from 1962 and with 137 million bbls recovered to date). Two existing oil pipelines cross the Catguas Block. As these are now underutilized, they provide important infrastructure for access to markets.

Although little exploration has taken place in the Catatumbo Basin within the past 25 years, the Catguas Block contains two wells, drilled in the late 1950s, which produced oil at rates which were then deemed by the previous operator as sub commercial due to low oil prices, poor fiscal terms and lack of infrastructure existing at the time of drilling. Solana is currently acquiring seismic over these prospects to determine whether follow up drilling is warranted. In addition Solana is currently acquiring seismic over a large structure which contains a well which, on the basis of two independent third party studies, is interpreted to contain a substantial column of oil pay in a fractured reservoir similar to that which produces in other fields in the region. Solana has staked a location on this prospect and is currently acquiring the environmental approvals required to drill this feature. A well is planned on this prospect in late 2006. A gas discovery, Esperanza, exists on the Catguas Block.



Middle Magdalena Basin



In addition to the prospects noted above a number of large exploration targets are believed by management of the Company to exist on the Catguas Block based on studies by previous operators and the Solana operated seismic program now underway. These are expected to provide follow-up drilling locations to any success encountered in the first drilling program to be conducted in 2006 and 2007.

The ANH Contract regarding the Catguas Block sets forth the following work program:

Phase 1: (18 months) acquire 200 km of 2D seismic data, reprocess 500 km of 2D seismic data and drill two exploration wells.

Phase 2: (18 months) drill one exploration well or potentially re-enter an existing well.

Phase 3 – 5: (each 12 months) drill one exploration well per phase.

Solana has committed to completing Phase 1 of the work program. The total cost of this phase is estimated at US$14.3 million. In the event that the results of these studies are positive, the Company will proceed with the subsequent phase(s). A deposit of US$1.428 million was provided by the Company to the ANH, and will be returned following the completion of the first phase in August 2007.

Solana Colombia entered into a contract in December 20, 2005 to have 200 kilometres of 2D seismic shot in the Catatumbo Basin, where the Catguas Block is located. This program is targeted at two significant leads defined by previous studies and described above, and the Company expects to complete the program by May 2006.

Solana has granted a 15% commercial interest in 253,000 acres comprising the southern area of the Catguas Block, and has also granted a 50% commercial interest in the remaining 140,000 acres, comprising the northern portion of the Catguas Block, to two private companies. Consequently, future costs, including the cost of the seismic program previously mentioned, will be paid according to the parties' respective commercial interests. Solana will remain as the operator.

Carbonera Block

In January 2006, Solana entered into an agreement with a private company pursuant to which Solana will receive a 50% interest in the Carbonera Block in the Catatumbo basin. This Block lies immediately adjacent to the southeast of the Catguas Block described above. The Carbonera Block contains an existing gas discovery of unknown size and includes three wells which tested gas and one dry appraisal well.

The ANH Contract regarding the Carbonera Block sets forth the following work program:

Phase 1: (16 months) acquire 38 km of 2D seismic data and re-enter one well (or if a re-entry is not feasible, drill one exploration well).

Phase 2: (12 months) drill one exploration well.

Phase 3 – 4: (each 12 months) drill one exploration well per phase.

Phase 5 – 6: (each 10 months) drill one exploration well per phase.

Solana has begun preliminary field work to prepare for a 38 km 2D seismic program to be acquired in the Carbonera Block. This project is expected to be completed by June 2006.

SOLANA / ARGOSY PROJECT

Guayuyaco 1 and 2

Guayuyaco 1 and 2, located in the Putumayo basin of southern Colombia are wells which discovered and appraised the Guayuyaco structure between March and June 2005. Solana paid 66.7% of the cost of the discovery well and 50% of the cost of the Guayuyaco 2 well and holds a 35% interest in the production.

The Guayuyaco 1 and 2 wells encountered oil pay in three zones; the Lower U, T and Caballos sands. Guayuyaco 1 encountered approximately 100 feet of oil pay and the Guayuyaco 2 well was structurally high to Guayuyaco 1 and encountered approximately

130 feet of aggregate net oil pay. Both the Guayuyaco 1 and 2 well have been completed and placed on production. Tests of the T sand have produced up to 1,100 bopd with low (7%) water cut. The Lower U sand has produced dry oil at up to 720 bopd. Currently Guayuyaco 1 is producing 425 bopd with 70% water cut and Guayuyaco 2 is producing 950 bopd with 27% water cut for a total net production to Solana Colombia of 500 bopd.

Oil produced in the Guayuyaco Block is transported a short distance to the pipeline at Orito where it is transferred to the ownership of Ecopetrol. The operator, Argosy, receives West Texas Intermediate price minus a differential that covers handling, transportation and quality and varies with the published price of WTI crude.

Chaza Block

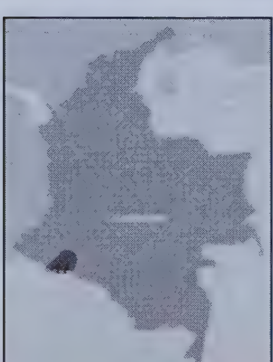
The Chaza Block covers an area of 80,200 acres and is located in the Putumayo basin to the west and north of the contiguous Guayuyaco Block. Argosy is the operator of the Chaza Block and the ANH has approved Argosy's assignment to Solana of a 50% interest in this acreage. Management believes that several drillable prospects exist on the Chaza Block based on work by previous operators and a recently completed Argosy 2D seismic program. The seismic program cost US$0.55 million net to Solana, and completes Phase 1 of the Chaza Block commitment. A second seismic program is planned for 2006 intended to convert known existing leads into drillable prospects.

LLANOS BASIN PROJECT

The Llanos Basin provides moderately sized, relatively low risk projects. The Company would hope to achieve reasonable cash flow from any successful wells due to the fact that wells in this area are known to produce at high rates (700 to 2,000 bopd) and because underutilized infrastructure exists in the region.

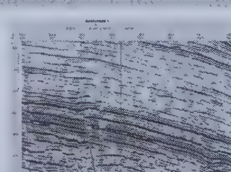
Solana Colombia entered into a drilling services agreement in December 2005 with a private company pursuant to which it has secured the rights to drilling services during the two-year period ending November 2007. Under this agreement, Solana Colombia has prepaid for drilling services, an amount of US$1.5 million, and also acquired the right to purchase a 50% interest in the service provider's equipment during the period ending April 11, 2006. Solana Colombia anticipates that this agreement will facilitate Solana Colombia complying with all of its drilling obligations for 2006 and 2007. This drilling rig is currently drilling the Gaviotas 1 well described below.

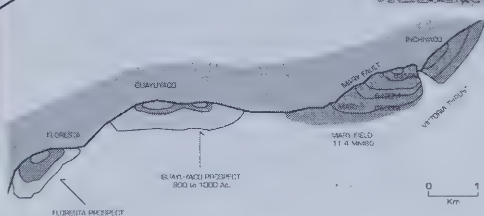
Solana is drilling or expects to drill an exploration well on three of the four Blocks described below within the next six months. The well on the Guachiria Sur Block is expected to be drilled within twelve months.



Puntumayo Basin

Guayuyaco Block





Gaviotas 1 Prospect, Gaviotas Block

The Gaviotas 1 Prospect is located on the Gaviotas Block, in the Llanos Basin. The Gaviotas 1 well was spudded in April 2006. This well is expected to be drilled to a final total depth of approximately 12,000 feet. Solana has farmed out a 50% interest in this block and retains a 50% interest in production. Two private companies are paying 100% of the cost of the Gaviotas well and will be entitled to a 50% share of the production.

Bonaire 1 Prospect, Guachiria Norte Block

The Bonaire 1 Prospect is located on the Guachiria Block, in the Llanos Basin, and is close to the discoveries and facilities previously mentioned. The Bonaire 1 well was spudded in March 2006 and drilled to a total depth of 7,800 feet. Based on shows seen in the samples and log analysis, Solana's management believes that the well warrants testing. Accordingly casing has been run to 7,783 feet and cemented. The well has been suspended and the drilling rig released pending the sourcing of a workover rig. When such a rig has been acquired Solana plans to test two zones in the Carbonera formation in the Bonaire 1 well. Solana bears 40% of the cost of the Bonaire well while retaining a 70% working interest with a Colombian partner bearing 60% of the costs and earning 30% of the production.

Yalea Prospect, Guachiria Sur Block

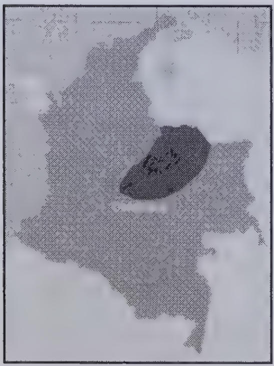
The Yalea Prospect is located on the Guachiria Sur Block, in the Llanos Basin, and is close to the Bucaro well which is currently producing at low rates and which has underutilized oil handling facilities. A Solana completed 2D seismic program has been interpreted and on that basis it is believed that the Yalea feature has a structural culmination somewhat higher than that at the Bucaro well. This is believed by Solana to reduce the risk inherent in this feature and that factor plus relatively modest anticipated drilling costs and proximity to the producing Bucaro field makes it an attractive target.

Seismic Programs, Llanos Basin

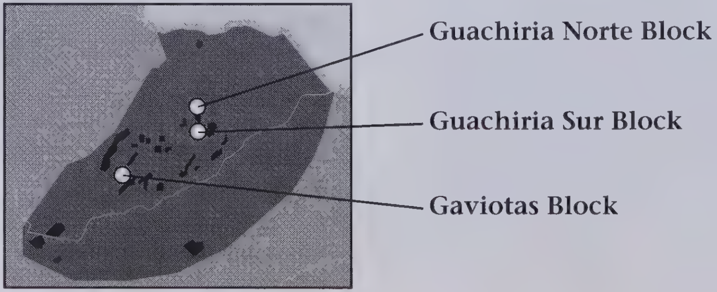
Solana entered into a contract in December 2005 to have 300 km of 2D seismic shot in the Llanos Basin, where the Gaviotas, Guachiria Norte, Guachiria Sur and Garibay Blocks are located. This group of seismic programs was subsequently increased to approximately 400 km to cover additional leads, to provide an extensive inventory of prospects for future drilling and to take advantage of lower seismic acquisition rates prevailing at the time the contract was signed compared to current costs. These programs have been completed and is expected that they will be fully processed and ready for interpretation by May 2006, the total cost of this group of programs was US$2.8 million.

Farmout Activity, Llanos Basin

In October 2005, Solana entered into agreements pursuant to which a private company may earn an interest in Solana's Gaviotas, Guachiria Sur,



Llanos Basin



Guachiria Norte and Guachiria Blocks. The contracts provide for the private company to pay 60% of the cost of the first exploration well drilled on each Block to earn a 30% interest in production in each of the Blocks. An additional exploration well will be drilled on one of the Blocks, rather than the private company reimbursing Solana for historical costs. Ongoing future costs (other than the drilling of each well on the Blocks) including the above mentioned seismic program will be paid 70% by Solana and 30% by the private company. Solana will remain the operator.

OTHER DRILLING ACTIVITIES

Molino de Viento Prospect, Salinas Block, Guajira Basin

The Molino de Viento well was drilled in the Salinas Block in the Guajira Peninsula between April 12, 2005 and March 1, 2005 and resulted in a dry hole and was abandoned, at a cost of US$2.1 million, net to Solana.

Sirruma 1 Prospect, Salinas Block, Guajira Basin

The Sirruma 1 well was drilled in the Salinas Block in the Guajira Peninsula between February 20, 2005 and March 18, 2005. This well was a non-commercial gas well and was abandoned, at a cost of US$2.2 million, net to Solana.

Balu Prospect, Upper Magdalena Valley

The Balu prospect, in the Upper Magdalena Valley, was drilled between September 1, 2005 and September 14, 2005 and failed to find significant hydrocarbons. This well was declared a dry hole and abandoned, at a cost of US$0.69 million, net to Solana.

Bucaro Project

The Bucaro 1 well, located on the Guachiria Block, and which had been drilled in 1989 was initially tested at approximately 700 bopd by the original operator. This well was then suspended by the original operator was re-entered, in 2005, by a third party partner of Solana. The well flowed under natural flow conditions during the period September 23 to 26, 2005 and produced a total of 480 barrels of 27 degree API oil over three days with an increasing water cut. It ceased to flow at the end of the test period. This well has been completed with a jet pump and put on commercial production with produced liquids treated on site and the oil trucked 140 km to the sales point. Since re-completion the Bucaro 1 well has experienced water production problems and a remedial job was performed to attempt a cement squeeze to isolate water bearing zones from those which are oil producing. This appears to have been only partially successful and the well continues to produce at a high water cut. Solana is entitled to a 68% interest in production from the Bucaro 1 well after deduction of various royalties and after the third party, who assumed the capital costs and risk of the Bucaro re-completion, has recovered double its current investment in the project. Solana is uncertain as to whether and when it will receive revenues from this well.

Operating Results

Selected Annual Information

The following table summarizes selected financial data for Solana for each of the three most recently completed financial years. Unless otherwise noted, all currency amounts are stated in Canadian dollars.

	2005	*2004*	*2003*
	$	$	$
Production Revenue, net of royalties	8,120,637	427,979	—
Operating costs	1,785,607	480,995	—
	6,335,030	(53,016)	—
Expenses			
General and administrative	3,441,911	1,252,174	553,840
Depletion, depreciation and accretion	5,686,362	1,519,952	—
Foreign exchange (gain) loss	(234,102)	522,371	—
Stock-based compensation	2,171,130	1,148,726	54,822
	(11,065,301)	(4,443,223)	(608,662)
Other income/expenses			
Interest and other	862,792	172,608	3,447
Capital taxes	(252,716)	(186,918)	—
	610,076	(14,310)	3,447
Net loss	4,120,195	4,510,495	605,215
Net loss per share	0.06	0.16	0.06
Share capital and warrants	110,910,147	110,257,972	15,279,615
Working capital	28,457,255	58,678,428	2,802,826
Petroleum and natural gas properties	73,618,637	45,304,339	3,317,376
Total assets	111,807,270	107,189,147	7,127,494
Total long-term liabilities	6,725,565	6,523,028	—
Shareholders' equity	98,146,787	98,680,852	7,094,046
Cash dividends per share	NIL	NIL	NIL

This consolidated financial information includes the revenue and expenses of Solana Colombia for the year ended December 31, 2005 and only the month of December for the year ended December 31, 2004. As a result, revenue from operations amounting to $8,120, 637 less the operating costs of $1,785,607 yielded operating profit of $6,335,030. During the year ended December 31, 2004 the Company generated revenue from operations of $427,979, less operating costs of $480,995, which yielded an operating loss of $53,016.

General and administrative expenses for the year ended December 31, 2005 amounted to $3,441,911 in comparison to $1,252,174 for the same period ended December 31, 2004, an increase of 175%. The major components of general and administrative expenses are as follows:

	2005	*2004*
	$	$
General office	594,775	515,405
Salaries	1,140,216	99,438
Professional fees	865,817	85,210
Public company costs	234,455	129,320
Consulting fees	426,004	372,929
Travel	180,644	49,818

All the categories of general and administrative expenses increased due to significantly increased operation and exploration activities of the Company.

Depletion, depreciation, accretion and impairment amounted to $5,686,362 for the year ended December 31, 2005 in comparison to the year ended December 31, 2004, which was $1,519,952. The depletion expense is calculated based on the decline in proved reserves in the Company's reserve report, and amounts to $5,515,209 in comparison to the year ended December 31, 2004, it amounted to $301,047 for only one month of operations. Depreciation amounts to $112,158 (2004 - $19,897) on the Company's capital assets, primarily office furniture, office equipment, vehicles and leasehold improvements.

Accretion expense amounting to $58,995 (2004 - $39,008) is representative of the Company's future estimated costs to plug and abandon its petroleum and natural gas wells at the end of their useful lives.

For the year ended December 31, 2004, the Company's impairment charge amounted to $1,160,000, for the Inchiyaco and Guepaje properties.

The foreign exchange gain amounting to $234,102 (2004 – foreign exchange loss of $522,317) reflects substantially the overall appreciation of the Colombian peso against the US dollar, and the appreciation of the CDN dollar against the US dollar by year end.

Stock-based compensation increased to $2,171,130 (2004 - $1,148,726) primarily from the amortization of costs associated with the vesting of options granted throughout 2005.

Other income and expenses relate to interest income in 2005 amounting to $862,762 compared to $172,608 in 2004 which is representative of the larger cash balances held throughout 2005.

The capital tax expense amounting to $252,716 (2004 - $186,918) was incurred in Colombia for the taxation year ended December 31, 2005, where as the comparative amount for the year ended December 31, 2004 was evenly incurred in both Canada and Colombia.

The resulting net loss amounting to $4,120,195 for 2005 relative to the net loss amounting to $4,510,495 for 2004 reflects the continued activity of the Company in general and its focused efforts in Colombia.

Summary of Quarterly Results

	QUARTERS ENDED			
	December 31, 2005	*September 30, 2005*	*June 30, 2005*	*March 31, 2005*
	$	$	$	$
Additions to Petroleum and Natural Gas properties	12,055,993	7,045,475	6,350,471	8,234,026
Total revenues	3,690,011	2,412,941	2,381,774	498,703
General and administrative expenses	1,126,933	711,020	893,827	710,131
Depletion, depreciation and accretion	4,665,478	390,288	496,713	133,883
Foreign exchange (gain) loss	(331,567)	236,457	408,500	(547,492)
Stock-based compensation	766,478	434,000	366,122	604,530
Loss before and after extraordinary items and taxes	2,289,806	753,343	546,216	530,830
Loss per share (basic and diluted)	0.04	0.01	0.02	0.01

	December 31, 2004	*September 30, 2004*	*June 30, 2004*	*March 31, 2004*
	$	$	$	$
Additions to Petroleum and Natural Gas properties	13,125,680	529,124	117,789	25,891
Total revenues	557,233	9,123	18,812	15,419
General and administrative expenses	707,660	337,832	89,547	117,135
Depletion, depreciation and accretion	359,952	-	-	-
Impairment	1,160,000	-	-	-
Foreign exchange	522,317	-	-	-
Stock-based compensation	1,102,826	-	-	45,900
Loss before and after extraordinary items and taxes	3,963,435	328,709	70,735	147,616
Loss per share (basic and diluted)	0.14	0.01	0.01	0.01

Liquidity

Solana's working capital decreased from $58,678,428 in 2004 to $28,457,255 in 2005 substantially due to the exploration activities of the Company during 2005.

Cash balances at December 31, 2005 amounting to $24,088,484 and net proceeds from the Company's April 2006 financing, amounting to $39,230,000, are committed to the Company's planned capital expenditure program in Colombia, which is expected to result in eight additional exploration wells drilled in 2006 and 2007. Management believes the Company currently has sufficient working capital to meet these commitments.

Long-term liabilities are $6,725,565 (2004 - $6,523,028) and the most significant component is the $6,100,000 future tax liability which arose on the acquisition of Solana Colombia. The future tax liability represents the potential future tax on the disposition of the assets of Solana Colombia by Solana that will not be shielded by any tax basis on those assets.

Shareholders' equity decreased from $98,680,852 in 2004 to $98,146,787 and is indicative of the growth of the Company's petroleum and natural gas assets, with a similar reduction to its cash equivalents, and a net loss for the year ended December 31, 2005 amounting to $4,120,195.

Summary of Cash Inflows and Outflows

The Company incurred a cash inflow from operations amounting to $3,627,849 compared to cash outflows in 2004 amounting to $1,565,426, primarily as a result of the oil production from the Guayuyaco field in 2005.

Solana's net cash inflow from financing activities amounted to $1,314,865 in 2005 compared to $68,173,575 in 2004, net of share issuance costs, from its various financings throughout 2004.

The Company incurred cash outflows from its investing activities of $38,886,111 in 2005 relative to $19,269,435 in 2004. The most significant component of the cash outflows was $33,685,965 in 2005 (2004 - $13,798,484) of expenditures for petroleum and natural gas properties.

Related Party Transactions

The Company paid $96,000 in management fees in 2005 (2004 - $122,000) to a company controlled by a director and officer of the Company and are included in general and administrative expense.

Business Risk and Uncertainties

The Company's business is subject to risks inherent in oil and gas exploration and development operations. In addition, there are risks associated with the Company's development stage of operations and the foreign jurisdiction in which it operates. The Company has identified certain risks pertinent to its business, including: exploration and reserve risks, drilling and operating risks, costs and availability of materials and services, capital markets and the requirement for additional capital, loss of or changes to production sharing, joint venture or related agreements, economic and sovereign risks, possibly of less developed legal systems, reliance on strategic relationships, market risk, volatility of future oil and gas prices and foreign currency risk.

Solana attempts to monitor, assess and mitigate certain of these risks by retaining an experienced team of professionals and using modern technology. Further, the Company has focused its activities in a known hydrocarbon basin in a jurisdiction that has previously established long-term oil and gas ventures with foreign oil and gas companies, existing infrastructure of services and oil and gas transportation facilities, and reasonable proximity to markets. The Company also retains consultants resident in Colombia to monitor economic and political developments and to assist with operating, administrative and legal matters. There are certain risks, however, over which the Company has little or no control.

Outlook

The Company intends to complete its eight-well exploratory drilling program in early March 2007. As of April 2006, the Company has drilled four successful and four unsuccessful wells.

Critical Accounting Policies and Estimates

Petroleum and Natural Gas Operations
Solana follows the full cost method to account for its petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized and accumulated in country-by-country cost centers. These capitalized costs will be depleted using the unit-of-production method based on estimates of proved reserves. The costs in cost centers from which there has been no commercial production are not subject to depletion until commercial production commences. These capitalized costs are assessed to determine whether it is likely such costs will be recovered in the future. Costs which are not likely to be recovered in the future are written off.

Petroleum and natural gas reserves form the basis for a number of accounting estimates and support for the carrying amount of petroleum and natural gas properties. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. The Company expects that its estimates of reserves will change to reflect updated information. Reserve estimates can be revised upward or downward, based on the results of future drilling, testing, production levels and economics of recovery based on flow forecasts.

Advisory Regarding Forward-Looking Statements

This discussion and analysis contains forward-looking statements. Forward-looking statements are subject to numerous known and unknown risks and uncertainties, some of which are beyond Solana's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange rate fluctuations, reserve estimates, environmental risks, and competition from other explorers, stock market volatility and ability to access sufficient capital. Solana's actual costs could differ materially from those anticipated in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.

April 27, 2006

Consolidated Financial Statements

for the years ended December 31, 2005 & 2004

Management's Report to the Shareholders

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial operating data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position, results of operations and changes in financial position, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the consolidated financial statements.

Management has established and maintains a system of internal control which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The consolidated financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsiblilities insofar as they relate to the fairness of reported operating results and financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

S. Newton

Stephen T. Newton
President

A. Scott Hamilton
Chief Financial Officer

Auditors' Report

To the Shareholders of Solana Resources Limited:

We have audited the consolidated balance sheets of Solana Resources Limited as at December 31, 2005 and 2004 and the consolidated statements of loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
April 27, 2006

Deloitte & Touche LLP
Chartered Accountants

Consolidated Statements of Loss and Deficit

	2005	2004
	$	$
REVENUE		
Oil and gas revenues, net of royalties	8,120,637	427,979
Interest and other	862,792	172,608
	8,983,429	600,587
EXPENSES		
Operating	1,785,607	480,995
General and administrative	3,441,911	1,252,174
Depletion, depreciation, accretion and impairment (Note 6)	5,686,362	1,519,952
Foreign exchange (gain) loss	(234,102)	522,317
Stock-based compensation (Note 11)	2,171,130	1,148,726
	12,850,908	4,924,164
Loss before taxes	(3,867,479)	(4,323,577)
Taxes (Note 13)	252,716	186,918
Net loss	(4,120,195)	(4,510,495)
Deficit, beginning of year (Note 1(h))	(12,951,276)	(8,440,781)
Deficit, end of year	(17,071,471)	(12,951,276)
Net loss per share, basic and diluted (Note 14)	(0.06)	(0.16)

Consolidated Balance Sheets

	2005	2004
	$	$
ASSETS		
CURRENT		
Cash and cash equivalents	24,088,484	55,104,406
Cash in trust (Note 3)	457,848	—
Accounts receivable	8,167,954	5,482,997
Prepaid expenses	2,677,887	76,292
	35,392,173	60,663,695
Restricted cash (Note 4)	—	900,000
Deposits (Note 5)	2,149,224	—
Petroleum and natural gas properties (Note 6)	73,618,637	45,304,339
Other capital assets (Note 7)	644,624	321,113
Investment (Note 8)	2,612	—
	111,807,270	107,189,147
LIABILITIES		
CURRENT		
Bank loans (Note 9)	—	100,135
Accounts payable and accrued liabilities	6,934,918	1,885,132
	6,934,918	1,985,267
Asset retirement obligations (Note 10)	625,565	423,028
Future income taxes (Note 13)	6,100,000	6,100,000
	13,660,483	8,508,295
SHAREHOLDERS' EQUITY		
Share capital and warrants (Note 11)	110,910,147	110,257,972
Contributed surplus (Note 11)	4,308,111	1,374,156
Deficit	(17,071,471)	(12,951,276)
	98,146,787	98,680,852
	111,807,270	107,189,147

Commitments and Contingencies (Notes 3, 4, 5 and 6)

APPROVED BY THE BOARD

Ray Antony, Director

Grant Howard, Director

Consolidated Statements of Cash Flows

	2005	2004
	$	$
SUMMARY OF ACTIVITIES		
OPERATING ACTIVITIES		
Net loss	(4,120,195)	(4,510,495)
Items not involving cash:		
Unrealized foreign exchange (gain) loss	(109,448)	207,091
Stock-based compensation	2,171,130	1,148,726
Depletion, depreciation, accretion and impairment	5,686,362	1,519,952
	3,627,849	(1,565,426)
Changes in non-cash working capital	1,909,948	1,348,875
Non-cash working capital acquired on acquisition	—	3,502,260
	5,537,797	3,285,709
FINANCING ACTIVITIES		
Repayment of demand loan	(100,135)	—
Proceeds from issuance of common shares	—	60,597,750
Proceeds from exercise of warrants	1,355,000	12,195,000
Proceeds from exercise of options	60,000	86,000
Share issuance costs	—	(4,705,175)
	1,314,865	68,173,575
INVESTING ACTIVITIES		
Additions to petroleum and natural gas properties	(33,685,965)	(13,798,484)
Cash deficiency acquired on acquisition of subsidiary	—	(168,202)
Additions to other capital assets	(443,748)	(305,126)
Deposits	(2,149,224)	—
Investment	(2,612)	—
Changes in non-cash working capital	(2,604,562)	(4,997,623)
	(38,886,111)	(19,269,435)
Foreign exchange on cash balances	217,662	(41,442)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(31,815,787)	52,079,106
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	55,904,271	3,825,165
CASH AND CASH EQUIVALENTS, END OF YEAR	24,088,484	55,904,271
Represented by:		
Cash and cash equivalents	24,088,484	55,104,406
Restricted cash	—	900,000
Bank loans	—	(100,135)
	24,088,484	55,904,271

Supplemental Cash Flow Information - See Note 15

1. SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Presentation

The consolidated financial statements include the accounts of Solana Resources Limited (the "Company"), formerly named Adulis Resources Inc., and its wholly-owned subsidiaries, Solana Petroleum Exploration (Colombia) Limited ("Solana Colombia") and Bayford Investments Limited ("Bayford").

The Company requires additional financing in order to fund its ongoing exploration programs. Management intends to raise the required financing through a combination of equity issues or farm-outs or by other means.

b. Petroleum and Natural Gas Operations

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized in country-by-country cost centres. Such costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, interest costs on major development projects and overhead charges directly related to acquisition, exploration and development activities.

The costs (including exploratory dry holes) in cost centres from which there has been no commercial production are not subject to depletion until commercial production commences. The capitalized costs are assessed to determine whether it is likely such costs will be recovered in the future. To the extent there are costs which are not likely to be recovered in the future, they are written-off.

The costs in cost centres from which there is production, together with the cost of production equipment, are depleted and depreciated on the unit-of-production method, based on the estimated proved reserves after royalties. Petroleum and natural gas reserves and production are converted into equivalent units, based upon estimated relative energy content. Costs of acquiring and evaluating significant unproved properties are excluded from the depletion calculations. These unproved properties are assessed to determine whether impairment has occurred. When proved reserves are assigned or the carrying value of the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

Petroleum and natural gas properties are subject to a ceiling test in each reporting period to determine that the costs are not impaired and do not exceed the fair value of the properties. The costs are assessed to be not impaired if the sum of the undiscounted cash flows expected from the production of proved reserves and the cost of unproved properties, net of impairment allowances of unproved properties exceed the carrying value of the petroleum and natural gas properties. If the carrying value of the petroleum and natural gas properties is determined to be impaired, an impairment loss is recognized to the extent that the carrying value exceeds an estimated fair value. The fair value estimate is normally based on the sum of the discounted cash flows expected from the production of proved and probable reserves plus the cost of unproved properties, net of impairment allowances. The cash flows are estimated using forecast product prices and costs and are discounted using a risk-free interest rate.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would alter the depletion rate by more than 20%.

c. Asset Retirement Obligations

The fair value of obligations associated with the retirement, removal and site restoration of tangible long-lived assets are recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are estimates of statutory, contractual or legal obligations that the Company will reasonably be expected to incur and then discounted to their present value using the Company's adjusted risk-free interest rate. The liability is accreted over time for changes in the fair value of the liability through charges to accretion which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying asset. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

d. Joint Ventures

Substantially all of the Company's exploration, development and production activities are conducted jointly with others and accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

e. Revenue Recognition

Revenues associated with the sale of the Company's natural gas, natural gas liquids and crude oil are recognized when title passes to the customer.

f. Other Capital Assets

Office furniture, equipment and vehicles are recorded at cost. Depreciation is calculated using the straight-line method based on the estimated useful life of the assets. The annual depreciation rates used are:

Office furniture, equipment and vehicles	10, 10 and 30% respectively

Leasehold improvements are recorded at cost. Amortization is calculated based on the term of the lease.

g. Foreign Currency

All operations are considered financially and operationally integrated. Results of operations of foreign subsidiaries are translated using average exchange rates for revenues and expenses, except depletion, depreciation and accretion which are translated at the rates of exchange applicable to the related assets. Monetary items denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of

exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are recorded in the statements of loss and deficit.

h. Stock-Based Compensation

The Company has a stock option plan as described in Note 11. Effective January 1, 2004, the Company adopted the fair value method of accounting for stock options, on a retroactive basis, without restatement of prior years. Prior to January 1, 2004, the Company measured stock-based compensation using the intrinsic value method for the award at the date of grant. As the exercise price and the market price were the same at the grant date, no compensation expense was recognized in 2003 and 2002 on the granting of stock options.

As a result of the adoption of this new accounting policy, the Company recorded a charge to deficit at January 1, 2004 and a credit to contributed surplus of $131,573 to reflect the accumulated expense of stock options granted under the plan subsequent to January 1, 2002. The estimated fair value of the stock options issued in 2003 and 2002 has been determined using the Black-Scholes option-pricing model.

i. Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax basis. Income tax expense (recovery) is computed based on the change during the year in the future tax assets and liabilities. Effects of changes in tax laws and tax rates are recognized when substantively enacted.

The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

j. Cash and Cash Equivalents

Cash and cash equivalents includes short-term investments with a maturity of 90 days or less.

k. Measurement Uncertainty

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles. Management makes estimates and assumptions that affect the reported amounts of assets, including petroleum and natural gas properties, and liabilities, including asset retirement obligations, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and revenues and expenses, including depletion, depreciation and accretion, and impairment, during the reporting period. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future periods could be significant.

l. Loss Per Share

The basic loss per share is determined using the weighted average number of shares outstanding during the year. The diluted loss per share, which is calculated using the treasury method, is equal to the basic loss per share due to the anti-dilutive effect of stock options and warrants.

2. ACQUISITION

Pursuant to an agreement dated June 25, 2004, the Company acquired all the issued and outstanding shares of Solana Colombia in exchange for 12,000,000 common shares at an ascribed price of $2.00 per common share. The transaction was completed with a concurrent financing on December 2, 2004. As a result, these consolidated financial statements include the operations of Solana from December 2, 2004 to December 31, 2004.

The allocation of the purchase price, which has been accounted for using the purchase method, was as follows:

	$
Net assets acquired:	
Cash deficiency	(168,202)
Current assets	552,114
Petroleum and natural gas properties	34,118,596
Current liabilities	(4,054,373)
Other capital assets	35,885
Asset retirement obligation	(384,020)
Future income tax liability	(6,100,000)
	24,000,000
Consideration:	
Common shares	24,000,000

3. CASH IN TRUST

The Company holds funds in trust totaling $457,848 for a joint venture partner and the funds will be released upon the completion of the obligations of the partner.

4. RESTRICTED CASH

On December 5, 2003, the Company acquired the rights to an exploration property in Colombia and an associated US$750,000 term deposit. The term deposit was being held by the Royal Bank of Canada as security for a letter of credit issued in favor of Ecopetrol S.A. The term deposit was returned to the Company on completion of its exploration commitment related to the property in November 2005.

5. DEPOSITS

The Company has placed funds on deposit totaling $2,149,224 with the Agency of National Hydrocarbons ("ANH") with respect to recently acquired acreage awarded to it. These funds will be returned to the Company on completion of the Phase I work commitments on the Guachiria Norte, Catguas, Guachiria Sur and Garibay Blocks.

6. PETROLEUM AND NATURAL GAS PROPERTIES

December 31, 2005	*Cost*	*Accumulated Depletion and Impairment*	*Net Book Value*
	$	$	$
Oil and gas properties	78,844,085	6,976,256	71,867,829
Inventory	1,750,808	—	1,750,808
	80,594,893	6,976,256	73,618,637
December 31, 2004	*Cost*	*Accumulated Depletion and Impairment*	*Net Book Value*
	$	$	$
Oil and gas properties	45,179,036	1,461,047	43,717,989
Inventory	1,586,350	—	1,586,350
	46,765,386	1,461,047	45,304,339

For the year ended December 31, 2005, the Company capitalized overhead costs relating to exploration and development activities in Colombia of $NIL (December 31, 2004 - $Nil). The Company incurred an impairment charge of $NIL (December 31, 2004 - $1,160,000).

Amounts excluded from depletion and depreciation amount to $52,554,605 and (2004 - $44,133,695) related to unevaluated properties, inventory and undeveloped lands.

Inventory consists of drilling materials and supplies and are classified as capital assets as they will be used for oil and gas exploration. However, these amounts are not depreciated, as they have not been used.

The benchmark prices of West Texas Intermediate Crude Oil were used in the impairment calculation are as follows:

Year	US $/ Barrel
2006	58.00
2007	56.38
2008	52.53
2009	51.69
2010	52.72
Average remainder	57.11

Block and Acreage Commitments

The Company has minimum exploration commitments of $48,318,000 over the next 12 to 18 months.

7. OTHER CAPITAL ASSETS

December 31, 2005	*Cost*	*Accumulated Amortization and Depreciation*	*Net Book Value*
	$	$	$
Office furniture, equipment and vehicles	538,516	86,781	451,735
Leasehold improvements	246,242	53,353	192,889
	784,758	140,134	644,624
December 31, 2004	*Cost*	*Accumulated Amortization and Depreciation*	*Net Book Value*
	$	$	$
Office furniture and equipment	94,768	15,794	78,974
Leasehold improvements	246,242	4,103	242,139
	341,010	19,897	321,113

8. INVESTMENT

The Company has invested $2,612 in the Colombian Hydrocarbon Investment Fund ("Fund"), and expects to invest a maximum amount of US $500,000. The Fund is managed by a U.S.-based fund manager, who specializes in investments in the natural resources sector in South America.

The Fund is expected to have an investment period of four years. After this period, the fund will be wound up, and any initial capital remaining and any earned profits will be returned and distributed to the investors over a maximum period of seven years.

9. BANK LOANS

The Company has a line of credit, up to $120,000, at an effective interest rate of 6% and is guaranteed by way of a promissory note. As at December 31, 2005, $NIL (2004 - $45,280) was drawn on the line of credit.

Solana has an unsecured bank loan, up to $120,000, at an annual interest rate of 12%. As at December 31, 2005, $ NIL (2004 - $54,855) was drawn on this bank loan. Interest expense is included in general and administrative expenses and totaled $3,837 (2004 -$13,166).

10. ASSET RETIREMENT OBLIGATIONS

The Company has an obligation to plug and abandon its petroleum and natural gas wells at the end of their useful lives. The present value of this obligation has been projected using estimates of the future costs and the timing of abandonment. At December 31, 2005, the Company estimated the present value of its asset retirement obligations to be $625,565, based on a future liability of $1,690,000. These costs are expected to be incurred near the end of the exploitation phase under the production sharing contract, around 2025. A credit-adjusted risk-free discount rate of 10% and an inflation rate of 2.5% were used to calculate the present value.

	$
Balance, December 31, 2003	—
Obligation assumed on acquisition	384,020
Accretion	39,008
Balance, December 31, 2004	423,028
Obligations incurred during the year	143,541
Obligations settled during the year	-
Accretion	58,996
Balance, December 31, 2005	625,565

11. SHARE CAPITAL

Authorized share capital consists of an unlimited number of common shares.

Issued	*Number*	*Amount* $
Common shares:		
Balance, December 31, 2003	20,980,792	15,032,916
Exercise of stock options	360,000	86,000
Fair value of stock options exercised	—	29,782
Private placement (Note 11(a))	5,300,000	10,600,000
Conversion of Salinas rights (Note 11(b))	1,500,000	2,775,000
Exercise of purchase warrants (Note 11(a))	5,300,000	11,925,000
Exercise of broker warrants (Note 11(c))	450,000	270,000
Prospectus (Note 11(d))	18,181,000	49,997,750
Acquisition of subsidiary (Note 11(e))	12,000,000	24,000,000
Fair value of warrants exercised		246,699
Share issue costs:		
Fair value of warrants granted	—	(1,385,708)
Other share issuance costs	—	(4,705,175)
Balance, December 31, 2004	64,071,792	108,872,264
Exercise of stock options	100,000	60,000
Exercise of broker warrants (Note 11(a and d))	565,000	1,355,000
Fair value of warrants exercised	—	577,438
Fair value of stock options exercised	—	45,445
Balance December 31, 2005	64,736,792	110,910,147

Warrants:

	Number	Amount
		$
Balance, December 31, 2003	450,000	246,699
Fair value of warrants granted	1,355,860	1,385,708
Fair value of warrants exercised	(450,000)	(246,699)
Balance, December 31, 2004	1,355,860	1,385,708
Fair value of warrants exercised	(565,000)	(577,438)
Fair value of warrants expired	(790,860)	(808,270)
Balance December 31, 2005	—	—

Contributed surplus:

Balance, December 31, 2003	123,639
Change in accounting policy – stock-based compensation	131,573
Stock-based compensation expense	1,148,726
Transfer to share capital on exercise of stock options	(29,782)
Balance, December 31, 2004	1,374,156
Stock-based compensation expense	2,171,130
Transfer from warrants on expiry of warrants	808,270
Transfer to share capital on exercise of stock options	(45,445)
Balance December 31, 2005	4,308,111

(a) On June 23, 2004, the Company completed a Private Placement of 5,300,000 units at a price of $2.00 per unit for total gross proceeds of $10,600,000. Each unit consisted of one common share and one common share purchase warrant (a "Warrant"). Each full warrant will be exercisable at a price of $2.50 during the period expiring September 25, 2004. These warrants were subsequently re-priced to a price of $2.25 and exercised on September 29, 2004. In consideration of acting as agent of Solana in connection with the Private Placement, the agent received a commission of $775,125 cash and 265,000 Broker Warrants. The agent also received a commission of 6.5% of the proceeds received by the Company on the exercise of the Warrants and Broker Warrants. Each Broker Warrant entitles the agent to purchase one common share at the price of $2.00 per share during the period expiring on June 28, 2005. On March 7, 2005 the agent exercised 265,000 warrants for proceeds to the Company totaling $530,000.

(b) On December 5, 2003, the Company acquired the rights to an exploration property in Colombia and an associated US$750,000 term deposit (see Note 4), in exchange for 5,000,000 common shares. The Company granted a convertible gross overriding royalty ("GOR") of 3% from oil and gas production from the Salinas Block. The GOR was converted into 1,500,000 common shares on July 16, 2004.

(c) Total broker warrants of 450,000 were exercised in 2004 for 450,000 common shares at $0.60 per common share.

(d) The Company completed a prospectus on November 24, 2004, issuing 18,181,000 common shares for gross proceeds totaling $49,997,750. Included in the offering, the Company's agents received 1,090,860 broker warrants and commission of $2,241,190. The net proceeds to the Company were $47,756,560, after agents' commissions and professional fees. Of the 1,090,860 warrants, the agent exercised, in March 2005, 300,000 warrants for proceeds to the Company totaling $825,000, and the remaining 790,860 warrants expired unexercised.

(e) The Company acquired all of the issued and outstanding shares of Solana Colombia on December 2, 2004 for 12,000,000 common shares of the Company (Note 2).

(f) In the year ended December 31, 2005, the Company issued 2,390,000 stock options to be exercised for common shares.

The Company has granted options to purchase common shares to directors, officers, employees and non-employees. Each option permits the holder to purchase one common share of the Company at the stated exercise price. Options granted vest over three years commencing on the anniversary date of the grant and are exercisable on a cumulative basis over five years. In accordance with the Company's stock option plan, these options have an exercise price equal to the market price at the date of grant. At December 31, 2005, 4,015,000 (December 31, 2004 – 1,725,000) options were outstanding under the stock option plan. At December 31, 2005, 6,407,177 common shares were reserved for issuance under the stock option plan.

	December 31, 2005		December 31, 2004	
	Number of Shares	Weighted Average Exercise Price ($ Per Share)	Number of Shares	Weighted Average Exercise Price ($ Per Share)
Outstanding, beginning of year	1,725,000	0.43	1,142,500	0.43
Granted during the year	2,390,000	2.02	1,005,000	2.67
Exercised during the year	(100,000)	0.60	(360,000)	0.24
Expired or cancelled during the year	—	—	(62,500)	0.60
Outstanding, end of year	4,015,000	1.94	1,725,000	1.76
Exercisable, end of year	1,791,667	1.99	1,222,500	1.39

December 31, 2005

Exercise Price Range ($ per share)	Number of Options Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price ($ per share)	Number of Options Exercisable	Weighted Average Exercise Price ($ per share)
2.72	200,000	4.90	2.72	66,667	2.72
3.50	70,000	4.01	3.50	-	3.50
1.67	1,920,000	4.67	1.67	-	1.67
4.10	200,000	4.17	4.10	100,000	4.10
2.75	905,000	3.92	2.75	905,000	2.75
0.10	140,000	0.45	0.10	140,000	0.10
1.91	100,000	3.01	1.91	100,000	1.91
0.60	480,000	2.93	0.60	480,000	0.60
	4,015,000	4.08	1.94	1,791,667	1.99

Stock-based compensation expense of $2,171,130 (December 31, 2004 - $1,148,726) related to options granted to non-employees has been recognized in accordance with the fair value method with a corresponding credit to contributed surplus. Upon exercise of these options, the credit to contributed surplus is reversed to share capital. Upon the exercise of options in 2005, $45,445 (2004 - $29,782) was reclassified from contributed surplus to share capital.

The Company estimates the fair value of stock options granted, using the Black-Scholes option pricing model, with the following assumptions:

	December 31	
	2005	2004
Risk-free interest rate (%)	3.81	3.51
Expected life (years)	5	5
Volatility in the price of common shares (%)	104	100
Dividends per common share ($ per share)	—	—

The resultant weighted average fair value per option amounts to $1.65 (2004 – $1.45).

12. RELATED PARTY TRANSACTIONS

For the year ended December 31, 2005 management fees of $96,000 (December 31, 2004 - $122,000) were paid to a company controlled by an officer of the Company and are included in general and administrative expenses.

These fees are for management services rendered in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

13. TAXES

The provision for income taxes reported differs from the amounts computed by applying the combined Canadian federal and provincial income tax rates for the loss before tax provision due to the following:

	2005	*2004*
	$	$
Statutory tax rate	38%	39%
Loss before tax	(3,867,479)	(4,323,577)
Recovery of income taxes computed at combined rates	(1,469,642)	(1,686,195)
Non-deductible stock-based compensation	825,029	448,003
Increase in valuation allowance	644,613	1,238,192
	—	—
Capital taxes	252,716	186,918

The approximate tax effect of each type of temporary difference that gives rise to the Company's future tax assets and liabilities are as follows:

	2005	*2004*
	$	$
Future taxes arising on acquisition (Note 2)	(6,100,000)	(6,100,000)
Asset retirement obligation	188,000	127,000
Non-capital losses carried forward	1,488,000	1,180,000
Share issue costs	1,021,000	1,390,000
Less valuation allowance	(2,697,000)	(2,697,000)
Future income tax liability	(6,100,000)	(6,100,000)

The Company has Canadian non-capital losses carried forward of approximately $4,743,000. The consolidated financial statements do not reflect the potential tax benefit of these losses. These losses expire as follows:

	$
2006	297,000
2007	304,000
2008	267,000
2009	140,000
2010	230,000
2011	2,578,000
2012	927,000
	4,743,000

14. NET LOSS PER SHARE

Net loss per share is calculated using the weighted average number of shares outstanding during the year ended December 31, 2005 is 64,602,423 (December 31, 2004 – 29,010,689). Diluted loss per share is not presented due to its anti-dilutive nature.

15. SUPPLEMENTAL CASH FLOW INFORMATION

	2005	2004
	$	$
Cash income taxes paid	—	—
Cash interest paid	3,837	9,998

16. SEGMENTED INFORMATION

The Company's oil and gas activities are conducted in one geographic segment: Colombia. All activities relate to exploration and development of petroleum and natural gas in Colombia.

2005	*Canada*	*Colombia*	*Total*
	$	$	$
Oil and gas revenues, net of royalties	—	8,120,637	8,120,637
Interest	734,111	128,681	862,792
	734,111	8,249,318	8,983,429
Operating	—	1,785,607	1,785,607
General and administrative expenses	1,719,082	1,722,829	3,441,911
Depletion, depreciation and accretion	8,078	5,678,284	5,686,362
Foreign exchange (gain)loss	1,163,509	(1,397,611)	(234,102)
Stock-based compensation	2,171,130	—	2,171,130
	5,061,799	7,789,109	12,850,908
(Loss) income before taxes	(4,327,688)	460,209	(3,867,479)
Capital taxes	—	(252,716)	(252,716)
Net loss	(4,327,688)	207,493	(4,120,195)
Identifiable assets	29,348,742	82,458,528	111,807,270
Capital expenditures	29,812	34,099,901	34,129,713

2004	*Canada*	*Colombia*	*Total*
	$	$	$
Oil and gas revenues, net of royalties	—	427,979	427,979
Interest	169,358	3,250	172,608
	169,358	431,229	600,587
Operating	—	480,995	480,995
General and administrative expenses	972,453	279,721	1,252,174
Depletion, depreciation and accretion	2,015	1,517,937	1,519,952
Foreign exchange loss	221,492	300,825	522,317
Stock-based compensation	1,148,726	—	1,148,726
	2,344,686	2,579,478	4,924,164
Loss before taxes	(2,175,148)	(2,148,249)	(4,323,577)
Capital taxes	186,918	—	186,918
Net loss	(2,362,066)	(2,148,249)	(4,510,495)
Identifiable assets	62,231,789	44,957,358	107,189,147
Capital expenditures	3,359,578	10,744,032	14,103,610

17. FINANCIAL INSTRUMENTS

a. Foreign Currency Exchange Risk

The Company is exposed to foreign currency fluctuations as it holds United States Dollars and Colombian Pesos in cash and short-term investments. There are no exchange rate contracts in place.

b. Fair Values of Financial Instruments

The fair values of the Company's financial instruments, including cash and cash equivalents, cash in trust, accounts receivable and accounts payable approximate their carrying values due to their short terms to maturity. The fair value of the deposits is not significantly different than their carrying value.

c. Credit Risk

The majority of the accounts receivable are in respect of oil and gas operations. The Company generally extends unsecured credit to these customers and therefore the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by the size and reputation of the companies to which they extend credit. The Company has not experienced any material credit loss in the collection of accounts receivable to date.

d. Commodity Price Risk

Due to the volatility of commodity prices the Company is exposed to adverse consequences of declining prices. The Company may enter into oil and natural gas contracts in order to protect its cash flow on future sales from the potential adverse impact of declining prices. The contracts would reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of oil and natural gas. As at December 31, 2005 and 2004, the Company had not entered into any of these contracts.

18. DIFFERENCES BETWEEN CANADIAN AND US GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

These consolidated financial statements have been prepared in accordance with Canadian GAAP. These principles, as they pertain to the Company's consolidated financial statements, differ from United States GAAP ("U.S. GAAP") as follows:

a. Full Cost Accounting Principles

The full cost method accounting for crude oil and natural gas operations under Canadian and U.S. GAAP differ in the following respect. Under U.S. GAAP, a ceiling test is applied to ensure the unamortized capitalized costs in each cost centre do not exceed the sum of the present value, discounted at 10%, of the estimated unescalated future net operating revenue from proved reserves plus unimpaired unproved property costs less future development costs, related production costs and applicable taxes. Under Canadian GAAP, a similar ceiling test calculation is performed with the exception that cash flows from proved reserves are undiscounted and utilize forecasted pricing to determine whether impairment exists. However, in Canada, the impaired amount is measured using the fair value of reserves.

The application of full cost accounting principles as prescribed by U.S. GAAP results in the Company's 2005 net loss under Canadian GAAP being increased by approximately $3,020,000 (2004 - $150,000) in respect to depletion, depreciation and impairment charge to its oil and natural gas properties.

b. Stock-Based Compensation

The Company has a stock-based compensation plan as more fully described in Note 11. Under Canadian GAAP, compensation costs have been recognized in the financial statements for stock options granted to employees and directors since January 1, 2004. For U.S. GAAP, the Company uses the intrinsic value method of accounting for stock options granted to employees and directors whereby no costs are recognized in the financial statements, per APB opinion No. 25 as interpreted by FASB Interpretation No. 44.

The effect of applying this provision to the Company's U.S. GAAP financial statements results in a decrease to stock-based compensation in 2005 by $2,171,130 (2004 - $1,148,726) and a corresponding decrease to the Company's contributed surplus account and the Company's net loss.

c. Statement of Cash Flows

The Company presents cash flow from operations before changes in non-cash working capital as a subtotal in its consolidated statement of cash flows. Under U.S. GAAP, this disclosure does not have any standardized meaning and would not be presented.

The application of U.S. GAAP would have the following effects on the Company's consolidated statements of Loss and Deficit:

	2005	*2004*
	$	$
Net loss - Canadian GAAP	(4,120,195)	(4,510,495)
U.S. GAAP adjustments		
Depletion and impairment charge	(3,020,000)	(150,000)
Stock based compensation	2,171,130	1,148,726
Net loss - U.S. GAAP	(4,969,065)	(3,511,769)
Net loss - basic and diluted	(0.08)	(0.12)

The application of U.S. GAAP would have the following effect on the Company's deficit:

	2005	*2004*
	$	$
Net loss - U.S. GAAP	(4,969,065)	(3,511,769)
Deficit, beginning of year - U.S. GAAP	(11,820,977)	(8,309,208)
Deficit, end of year - U.S. GAAP	(16,790,042)	(11,820,977)

The application of U.S. GAAP would have the following effect on the Company's consolidated balance sheets:

December 31, 2005	*Canadian GAAP*	*U.S. GAAP*
	$	$
Petroleum and natural gas properties	73,618,637	70,448,637
Contributed surplus	4,308,111	931,909
Deficit	(17,071,471)	(16,790,042)

December 31, 2004	*Canadian GAAP*	*U.S. GAAP*
	$	$
Petroleum and natural gas properties	45,304,339	45,154,339
Contributed surplus	1,374,156	123,639
Deficit	(12,951,276)	(11,820,977)

19. SUBSEQUENT EVENT

The Company completed a final short form prospectus on April 18, 2006 to qualify for distribution 21,000,000 common shares at a price of $2.00 per common share. The net proceeds of the offering, after payment of the agents' commission of $2,520,000 and the estimated expenses of the offering of $250,000, was approximately $39,230,000 net to the Company.

Corporate Information

Directors
Raymond P. Antony, Chair [1 3 4]
Stan Grad, Director [2 4]
Grant Howard, Director [1 4]
Roy H. Hudson, Director [1 3 4]
Joaquin Moreno Uribe[2 3 4]
Stephen T. Newton, Director [2 4]

1 Audit Committee
2 Reserves Committee
3 Corporate Governance and Compensation Committee
4 Health, Environment and Safety Committee

Management
Stephen T. Newton, President / CEO
Menno Wiebe, Vice President Exploration
A. Scott Hamilton, Chief Financial Officer

Trading Symbols
TSX-V: SOR
LSE (AIM): SORL

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Abbreviations

CDN	Canadian
US	United States
WTI	West Texas Intermediate
bbl	barrel
bopd	barrels of oil per day
Mcf	thousand cubic feet
Mcfpd	thousand cubic feet per day
MMcf	million cubic feet
MMcfpd	million cubic feet per day
boe	*barrel of oil equivalent
boepd	*barrel of oil equivalent per day
NGL	natural gas liquids
TSX-V	TSX Venture Exchange
LSE	London Stock Exchange
AIM	Alternative Investment Market Of the London Stock Exchange
MD&A	Managements' Discussion and Analysis
GAAP	Generally Accepted Accounting Principles
G&A	General and Administrative Expenses

* A Boe conversion ratio of 6 Mcf = 1 Bbl has been used. Boe's may be misleading, particularly if used in isolation. A Boe conversion ratio of 6 Mcf to 1 Bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

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